

REPORT OF EXAMINATION  
OF THE

2-10 HBW WARRANTY OF CALIFORNIA, INC.

AS OF  
DECEMBER 31, 2005

Filed May 24, 2007

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Los Angeles, California  
April 30, 2007

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**2-10 HBW WARRANTY OF CALIFORNIA, INC.**

(hereinafter also referred to as the Company) at the primary location of its books and records, 10375 East Harvard Avenue, Denver, Colorado, 80231.

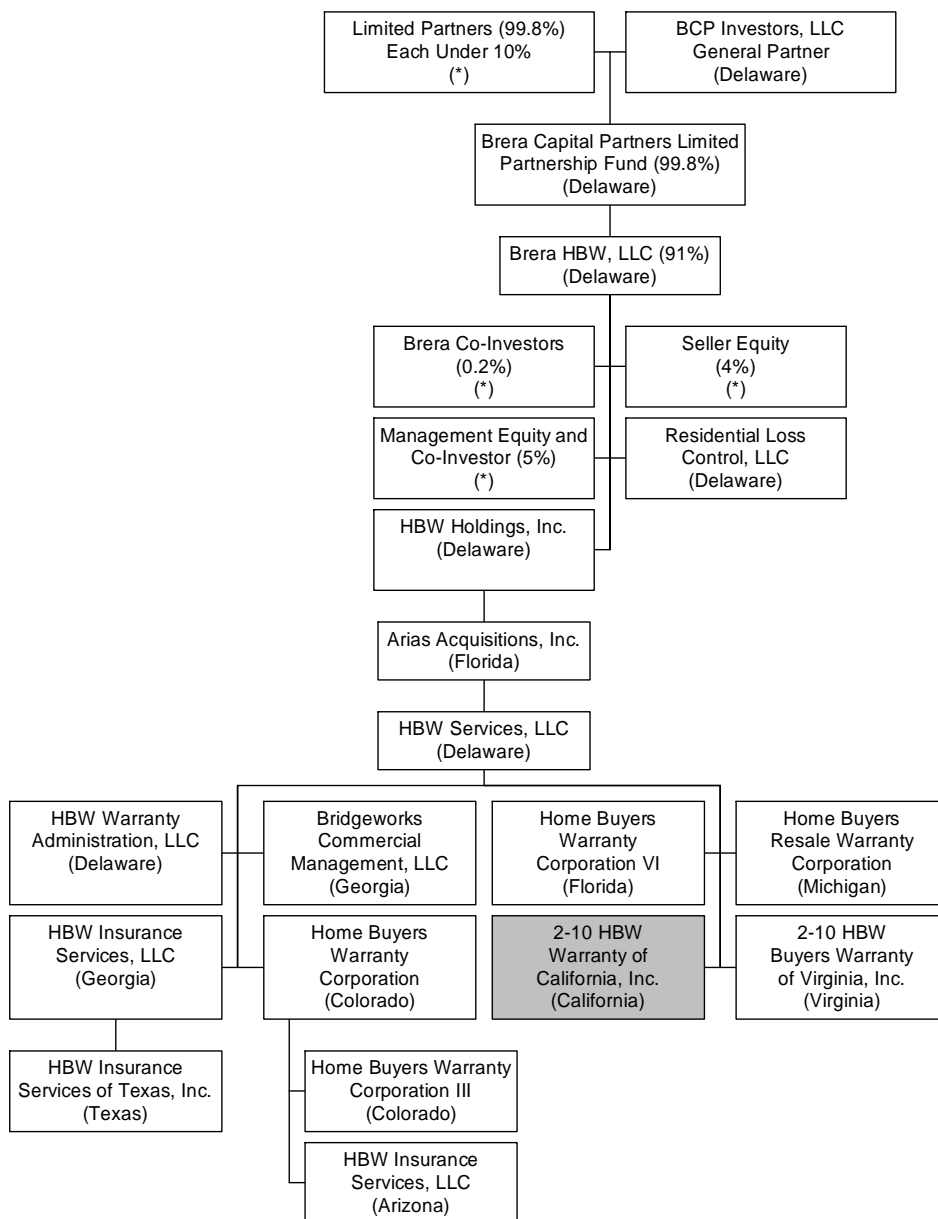
**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The present examination included a review of the Company's practices and procedures, examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; loss experience; accounts and records; and sales and advertising.

## MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of HBW Services, LLC, a Delaware limited liability company. The ultimate controlling entity is Brera Capital Partners Limited Partnership Fund, a Delaware limited partnership. The following abridged organizational chart depicts the Company's relationship within the holding company system:



All ownership is 100% unless otherwise noted

(\*) Individual investors and/or partners

Management of the Company is vested in a one-member board of director elected annually. Although the Company's bylaws were amended in 2002 to change the number of board members to one, it is recommended that the Company amend its bylaws to require additional directors. Good corporate governance and internal controls require, among other things, that a board be sufficient and capable of independent oversight in order to adequately perform the necessary governance, guidance and oversight of the Company's operations. A listing of the member of the board and principal officers serving on December 31, 2005 follows:

#### Director

##### Name and Residence

##### Principal Business Affiliation

Mark C. Lewis  
Centennial, Colorado

Treasurer and Chief Financial Officer  
2-10 HBW Warranty of California, Inc.

#### Principal Officers

##### Name

##### Title

David J. Jasko  
Wendy S. Fisher  
Mark C. Lewis  
Henry B. Allen

President  
Secretary  
Treasurer and Chief Financial Officer  
Vice President Sales – Resale Home Division

#### Management Agreements

Management Agreement: The Company is a party to a Management Agreement (Agreement) with its affiliate, Home Buyers Resale Warranty Corporation (HBRWC), a Michigan corporation. Services provided by HBRWC include: claims, underwriting, accounting, and data processing. Claims processing costs are allocated to the Company based on its proportionate share of paid claims among the companies managed by HBRWC. Compensation for all other services is determined by allocating HBRWC's administrative and overhead costs proportionally based upon gross revenue among the companies for which HBRWC performs these services. This Agreement was filed and approved by the

California Department of Insurance (CDI) as required under California Insurance Code (CIC) Section 1215.5(b)(4). Under the terms of the agreement the following fees were paid: \$883,231 in 2003; \$1,044,611 in 2004; and \$1,090,334 in 2005.

Marketing Agreement: The Company has a Marketing Agreement with its affiliate, HBRWC. Under the terms of the agreement, HBRWC provides a marketing program for the Company's resale home protection contracts. HBRWC receives a fee of 17% of the cost of each resale home warranty contract for full-time resale specialists and 8% for part-time resale specialists. This agreement was filed and approved by the CDI as required under CIC Section 1215.5(b)(4). Under the terms of the agreement the following fees were paid: \$215,494 in 2003; \$215,453 in 2004; and \$674,091 in 2005.

Tax Consolidation Agreement: The Company and its affiliates are part of a Tax Consolidation Agreement with its parent, HBW Holdings, Inc., a Delaware corporation. Home Buyers Warranty Corporation, a Colorado corporation, is the affiliate responsible for making federal income tax estimated and final payments on behalf of the affiliated group. Under the terms of the agreement, each company shall compute its separate tax liability as if it had filed a separate tax return and adjusts its intercompany tax balance to reflect the liability to HBW. This agreement was filed and approved by CDI as required under CIC Section 1215.5(b)(4).

### CORPORATE RECORDS

Although the Company's board minutes did provide a general statement authorizing and approving the investments as required by California Insurance Code (CIC) Section 1200, it failed to document and provide specific references to amounts, facts, and the value of the securities as required under CIC Section 1201. It is recommended that the Company implement procedures to ensure that specific references to amounts, facts, and the value of the securities are documented in its board minutes to comply with CIC Section 1201.

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report, both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the Commissioner, and enter that fact in the board minutes. A review of the board minutes during the examination period disclosed that the Company did not make the required reference. It is recommended that the Company implement procedures in its board meetings to ensure future compliance with CIC Section 735.

### TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact home protection business only in the State of California. In 2005, the Company had direct written premiums of approximately \$4.6 million. The Company specializes in resale business and utilizes sales representatives to market its product through the real estate community throughout California. The basic warranty contract is generally one year in length and covers major mechanical and plumbing systems as well as certain appliances for single family residential units and multiple units.

### REINSURANCE

The Company has no assumed or ceded reinsurance in force.

### FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2002 through December 31, 2005

Statement of Financial Condition  
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 4,444,152	\$	\$ 4,444,152	(1)
Cash on hand and on deposit	448,721		448,721	(2)
Home protection contract fees receivable	250,091		250,091	
Interest, dividends, and real estate income due and accrued	<u>33,597</u>	<u></u>	<u>33,597</u>	
Total assets	<u>\$ 5,176,561</u>	<u>\$ 0</u>	<u>\$ 5,176,561</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 164,275	
Other expenses			617,102	
Taxes, licenses and fees			19,902	
Federal income taxes			159,245	
Unearned home protection contract fees			<u>2,015,928</u>	
Total liabilities			2,976,452	
Common capital stock		\$ 200,000		
Gross paid-in and contributed surplus		250,000		
Unassigned funds (surplus)		<u>1,750,109</u>		
Surplus as regards contract holders			<u>2,200,109</u>	
Total liabilities, surplus and other funds			<u>\$ 5,176,561</u>	



Underwriting and Investment Exhibit  
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 4,186,208
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Deductions:

Claims incurred	\$ 1,439,832	
Claims services expense incurred	231,745	
Other expenses incurred	<u>2,239,084</u>	

Total deductions		<u>3,910,661</u>
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Net underwriting gain		275,547
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Investment Income

Net investment income earned	\$ <u>171,438</u>	
Net investment gain		171,438

Other Income

Miscellaneous (finance charge income)	\$ <u>50,245</u>	
Total other income		<u>50,245</u>

Net income, before federal income taxes		497,230
Federal income taxes incurred		<u>265,097</u>

Net income		<u>\$ 232,133</u>
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Capital and Surplus Account

Surplus as regards contract holders, December 31, 2004		\$ 1,975,917
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Net income	\$ 232,133	
Change in non-admitted assets	<u>(7,941)</u>	
Change in surplus as regards contract holders for the year		<u>224,192</u>

Surplus as regards contract holders, December 31, 2005		<u>\$ 2,200,109</u>
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Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2002 through December 31, 2005

Surplus as regards contract holders, December 31, 2002, per Examination			\$ 1,134,497
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 1,058,926	\$	
Change in non-admitted assets	<u>6,686</u>	<u>0</u>	
Totals	<u>\$ 1,065,612</u>	<u>\$ 0</u>	
Net increase in surplus as regards contract holders for the year			<u>1,065,612</u>
Surplus as regards contract holders, December 31, 2005, per Examination			<u>\$ 2,200,109</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds

As of December 31, 2005, the Company's bond portfolio was held with Key Bank which is not a qualified custodian pursuant to California Insurance Code (CIC) Section 1104.9. In July 2006, the Company transferred these securities to Union Bank of California, N.A, a qualified custodian.

### (2) Cash on Hand and on Deposit

The Company has not filed unclaimed property returns in the past and is aware that this is a problem. In an effort to comply, the Company continues to accrue for unclaimed property and plans to submit its first filing this year. It is recommended that the Company establish written escheat procedures, transfer stale checks to an escheatable account, and escheat unclaimed property to the State of California Controller's Office as required by the California Unclaimed Property Act.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control (Page 3): Although the Company's bylaws were amended in 2002 to change the number of board members to one, it is recommended that the Company amend its bylaws to require additional directors.

Corporate Records (Page 4): It is recommended that the Company implement procedures to ensure that specific references to amounts, facts, and the value of the securities are documented in its board minutes to comply with CIC Section 1201.

Corporate Records (Page 4): It is recommended that the Company implement procedures to ensure future compliance with CIC Section 735.

Cash on Hand and on Deposit (Page 9): It is recommended that the Company establish written escheat procedures, transfer stale checks to an escheatable account, and escheat unclaimed property to the State of California Controller's Office as required by the California Unclaimed Property Act.

#### Previous Report of Examination

Bonds (Page 10): It was recommended that the Company obtain a qualified custodian or transfer the securities to a custodian that meets the requirement of CIC Section 1104.9. The Company has complied with this recommendation.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Deanna Lo, AFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California